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SENSITIVE
SIPDIS

DEPARTMENT FOR EAP/ANP, EEB/TPP/BTA

E.O. 12958: N/A
TAGS: EFIN ECON ETRD AS
SUBJECT: POSITIVE BUDGET REVISION; RATES GO UP, AGAIN

¶1. (U) SUMMARY: Treasury released on November 2 revised budget
estimates showing the economy will undergo higher growth, lower
unemployment, lower deficits, and lower debt than previously
expected. Given the more positive outlook - and constant criticism
by Opposition of overspending - the GOA announced initial cuts in
its stimulus package. Treasurer Swan still warned that challenges
remain in areas like business investment and terms of trade.
Monetary policy responded quickly on November 3, when the Reserve
Bank of Australia raised interest rates once again by 25 basis
points to 3.5%. END SUMMARY.

Positive budget outlook

¶2. (U) Australian Treasury released on November 2 the 2009-10
Mid-Year Economic and Fiscal Outlook (MYEFO), which forecasts lower
unemployment, higher growth, lower deficits and lower debt than
previously expected. Australia's unemployment rate is now expected
to peak at 6.75%, instead of the 8.5% predicted in May, and which
translates to nearly 250,000 fewer unemployed. Inflation is
expected to be subdued at 2.25% in both 2009-10 and 2010-11. While
Australia's trade partners in Asia are recovering faster than
expected, the country's terms of trade are down 16.9% since
September 2008.

Deficits and debt revised down

¶3. (U) Forecasts for budget deficits and government debt are down
sharply, with the federal budget deficit to fall from 4.7% of GDP in
2009-10 to 1.1% by 2012-13, with a surplus expected in 2015-16.
Lower government deficits have improved GOA's debt position
considerably. By mid-2013, net debt is expected to be A$135 billion
(9.4% of GDP), down A$53 billion from the original budget estimate
of A$188.2 billion (13.6% of GDP).

First sign of scaling back fiscal stimulus

¶4. (U) The GOA is adjusting fiscal policy to the
earlier-than-expected economic recovery. Responding to calls from
the Opposition to reduce its fiscal stimulus, the GOA announced
expenditure reductions amounting to A$1.8 billion by 2013: holding
real growth in spending to 2% per year until the budget returns to
surplus; real government spending will contract in 2010-11 (the
first time in 20 years); the Environment Minister announced a cut of
A$250 million to the GOA's Home Insulation Program; and the Housing
Minister announced restrictions on first home grants.

Interest rates rise and Aussie dollar to stay high
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¶5. (U) The Reserve Bank of Australia on November 3 raised interest rates by 25 basis points to 3.5%. Commercial banks followed suit with a similar increase. This means Australians with a home loan will pay an extra A$46 per month. Most analysts believe the Australian dollar's yield differential will continue to widen against other major currencies, which should support it in the months ahead. Some dislocation is expected in export-oriented sectors of the economy affected by the high Australian dollar, such as manufacturing and agriculture.

¶6. (SBU) COMMENT: Economic recovery in Australia is proceeding faster than expected, reducing federal deficits and debt. Treasurer Swan's comments following the RBA rate increase suggest the likelihood of further increases in the future and warned that, despite the improved budget figures, the economy will operate "below Qdespite the improved budget figures, the economy will operate "below capacity for some time" and that challenges remain in areas like business investment and terms of trade. To add some perspective, even though tax receipts are forecast to increase by A$40 billion over the 5-year period to 2012-13, they are still down A$170 billion from the May 2008 forecast.

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